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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

TERARECON, INC.,

Plaintiff,

v.

FOVIA, INC.; FOVIA MEDICAL, INC.;
KENNETH FINEMAN; ROGER KATEN; GEORGE
BUYANOVSKY; IGOR OKULIST; and JOSEF
GOREK,

Defendants.

No. C 05-4407 CW

ORDER GRANTING
COUNTERDEFENDANTS'
MOTION TO DISMISS
COUNTERCLAIMS AND
GRANTING
PLAINTIFF'S MOTION
TO AMEND COMPLAINT

FOVIA, INC.; FOVIA MEDICAL, INC.; and
GEORGE BUYANOVSKY,

Counterclaimants,

v.

TERARECON, INC., MOTOAKI SAITO; and
ROBERT TAYLOR,

Counterdefendants.

Counterdefendants TeraRecon, Inc., Motokai Saito and Robert
Taylor move to dismiss, pursuant to Federal Rule of Civil Procedure

12(b)(6), the second, third and fourth claims for relief of the counterclaim filed by Counterclaimants Fovia, Inc., Fovia Medical, Inc. and George Buyanovsky. The Fovia parties oppose this motion. In addition, Plaintiff TeraRecon seeks leave to file its second amended complaint. Defendants Fovia, Inc., Fovia Medical, Inc., Kenneth Fineman, Roger Katen, George Buyanovsky, Igor Okulist and Josef Gorek oppose this motion in part. The matter was heard on May 12, 2006. Having considered all of the papers filed by the parties and oral argument on the motions, the Court grants the TeraRecon parties' motion to dismiss, with leave to amend, and grants the motion for leave to amend.

BACKGROUND

According to TeraRecon, it is a leader in advanced image processing and 3-D visualization techniques, providing imaging systems for medical and other visualization applications. In 1997, it created a volume rendering apparatus, now named Aquarius. TeraRecon has invested, and continues to invest, large amounts of time, effort and money in developing Aquarius. Fovia is TeraRecon's competitor; it develops and sells medical imaging applications that compete with TeraRecon's Aquarius. Fovia was formed by TeraRecon's former employees: Buyanovksy, Fineman, Katen, and Okulist. On October 28, 2005, TeraRecon filed this action against Fovia, Fovia Medical, its former employees, and Gorek, the fifth member of the Fovia management team, alleging copyright infringement, misappropriation of trade secrets and other State law claims.

1 In February, 2006, Fovia, Fovia Medical and Buyanovsky filed
2 counterclaims against TeraRecon and two additional
3 counterdefendants: Mitoaki Saito, TeraRecon's Chief Executive
4 Officer, and Robert Taylor, TeraRecon's Chief Operating Officer.
5 The counterclaims were for copyright infringement, unfair business
6 practices, intentional interference with prospective economic
7 advantage and negligent interference with prospective economic
8 advantage. The Fovia parties allege that, before joining
9 TeraRecon, Buyanovsky created a powerful software-based volume
10 rendering engine that could perform perspective and parallel volume
11 rendering. This engine is copyrightable subject matter under the
12 Copyright Act. Shortly after Buyanovsky was hired, Saito asked him
13 to develop and integrate perspective rendering into a TeraRecon
14 hardware-based product or, alternatively, to produce a software-
15 based perspective rendering engine. Saito wanted this done
16 quickly, before the 87th Scientific Assembly and Annual Meeting of
17 the Radiological Society of North America was held on November 24,
18 2001. This was impossible. After receiving pressure from Saito
19 and Taylor, Buyanovsky agreed to adapt his previously created
20 software engine solely for demonstration purposes at the
21 Radiological Society meeting. Buyanovsky did not grant TeraRecon
22 rights to use his engine in TeraRecon products after the
23 Radiological Society meeting. But TeraRecon continued to use
24 Buyanovsky's engine, or derivatives thereof, in its commercial
25 products without Buyanovsky's permission.

LEGAL STANDARD

I. Motion to Dismiss

A motion to dismiss for failure to state a claim will be denied unless it is "clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." Falkowski v. Imation Corp., 309 F.3d 1123, 1132 (9th Cir. 2002), citing Swierkiewicz v. Sorema N.A., 534 U.S. 506 (2002). All material allegations in the complaint will be taken as true and construed in the light most favorable to the plaintiff or counterclaimant. NL Indus., Inc. v. Kaplan, 792 F.2d 896, 898 (9th Cir. 1986).

A complaint must contain a "short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). "Each averment of a pleading shall be simple, concise, and direct. No technical forms of pleading or motions are required." Fed. R. Civ. P. 8(e). These rules "do not require a claimant to set out in detail the facts upon which he bases his claim. To the contrary, all the Rules require is 'a short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds on which it rests." Conley v. Gibson, 355 U.S. 41, 47 (1957).

When granting a motion to dismiss, a court is generally required to grant a plaintiff, or counterclaimant, leave to amend, even if no request to amend the pleading was made, unless amendment would be futile. Cook, Perkiss & Liehe, Inc. v. N. Cal. Collection Serv. Inc., 911 F.2d 242, 246-47 (9th Cir. 1990). In determining whether amendment would be futile, a court examines whether the

1 complaint could be amended to cure the defect requiring dismissal
2 "without contradicting any of the allegations of [the] original
3 complaint." Reddy v. Litton Indus., Inc., 912 F.2d 291, 296 (9th
4 Cir. 1990). Leave to amend should be liberally granted, but an
5 amended complaint cannot allege facts inconsistent with the
6 challenged pleading. Id. at 296-97.

7 II. Leave to Amend Complaint

8 Federal Rule of Civil Procedure 15(a) provides that leave of
9 the court allowing a party to amend its pleading "shall be freely
10 given when justice so requires." Leave to amend lies within the
11 sound discretion of the trial court, which discretion "must be
12 guided by the underlying purpose of Rule 15 to facilitate decision
13 on the merits, rather than on the pleadings or technicalities."
14 United States v. Webb, 655 F.2d 977, 979 (9th Cir. 1981) (citations
15 omitted). Thus, Rule 15's policy of favoring amendments to
16 pleadings should be applied with "extreme liberality." Id.; DCD
17 Programs, Ltd. v. Leighton, 833 F.2d 183, 186 (9th Cir. 1987).

18 DISCUSSION

19 I. Motion to Dismiss Second, Third and Fourth Counterclaims

20 After the TeraRecon parties filed their motion to dismiss, the
21 Fovia parties filed a stipulation and proposed order granting them
22 leave to file their first amended counterclaims. The Court signed
23 the stipulation and proposed order. The Fovia parties contend that
24 these revisions addressed and cured the issues raised in the motion
25 to dismiss. The TeraRecon parties disagree and pursue their motion
26 to dismiss with prejudice the second, third and fourth
27 counterclaims.

1 A. Unfair Competition in Violation of California Business
2 and Professions Code § 17200

3 Both parties acknowledge that the Copyright Act preempts State
4 law claims for unfair competition arising out of conduct
5 encompassed by the Copyright Act. See, e.g., Summit Mach. Tool
6 Mfg. Corp. v. Victor CNC Sys., Inc., 7 F.3d 1434, 1439-50 (9th Cir.
7 1993). But, as the Ninth Circuit has held, "If a state law claim
8 includes an 'extra element' that makes the right asserted
9 qualitatively different from those protected under the Copyright
10 Act, the state law claim is not preempted by the Copyright Act."
11 Altera Corp. v. Clear Logic, Inc., 424 F.3d 1079, 1089 (9th Cir.
12 2005). The Fovia parties contend that they have plead the
13 additional elements of affirmative misrepresentation and misleading
14 promises and thus their unfair competition claim is not preempted.
15 The TeraRecon parties disagree, arguing that the alleged
16 misrepresentations are nothing more than a re-characterization of
17 the Fovia parties' copyright claims and that the misrepresentations
18 are not sufficiently plead. In addition, the TeraRecon parties
19 argue that the Fovia parties' "reverse passing off" and
20 "appropriation" allegations do not support a claim under § 17200
21 and that the Fovia parties do not state a valid claim as to Saito
22 and Taylor.

23 1. Misrepresentation and False Promises

24 The amended counterclaim alleges:

25 TeraRecon's regular practice of using images rendered by
26 the Buyanovsky Engine in its marketing materials,
27 thereby improperly implying that they were created by
28 TeraRecon's products constitutes an unfair business
practice in violation of California Business and
Professions Code § 17200.

1 TeraRecon's regular practice of falsely representing
2 that its 3D volume rendering software taken from the
3 Buyanovsky Engine is exclusively its own product, was
4 created exclusively by its own employees and does not
incorporate the work of others constitutes an unfair
business practice in violation of California Business
and Professions Code § 17200.

5 Amended Counterclaim (ACC) ¶ 162-63.

6 A claim for copyright infringement need not contain an element
7 of deceit or misrepresentation. See 17 U.S.C. § 102. The Fovia
8 parties argue that therefore they have alleged an extra element and
9 the Copyright Act does not preempt their unfair competition claim.
10 See Valente-Kritzer Video v. Pinckney, 881 F.2d 772, 776 (9th Cir.
11 1989) ("VKV does allege the element of misrepresentation that
12 distinguishes this claim from one based on copyright."). It is not
13 that simple. Courts do not automatically conclude that, if
14 misrepresentation or deceit is alleged, a claim is not preempted by
15 the Copyright Act. See Litchfield v. Spielberg, 736 F.2d 1352,
16 1358 (9th Cir. 1984) (finding that insofar as the State law claims
17 for unfair competition and misrepresentation "are restatements of
18 the copyright infringement claims, they are preempted by federal
19 copyright law"). Rather, the Court must determine if the State law
20 claim is equivalent to any of the exclusive rights within the
21 general scope of copyright as specified by 17 U.S.C. § 106.
22 Valente-Kritzer Video, 881 F.2d at 776. Section 106 grants the
23 copyright owner exclusive rights of reproduction, production of
24 derivative works, distribution, and display. See 17 U.S.C. § 106.
25 As noted above, to survive preemption, the State claim must protect
26 rights which are qualitatively different from copyright rights and
27 "must have an 'extra element' which changes the nature of the
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1 action." Valente- Kritzer Video, 881 F.2d at 776.

2 The cases that the Fovia parties cite include an extra
3 element, which changed the nature of the action. For example, in
4 Valente-Kritzer Video, the plaintiff alleged that the defendant
5 intentionally misrepresented its intent to perform a contract. The
6 court found that the fraud cause of action, based on the allegation
7 that the defendant misrepresented its intent to perform a contract,
8 "is not substantially equivalent to a claim for copyright
9 infringement." Id. In Dielsi v. Falk, 916 F. Supp. 985 (C.D. Cal.
10 1996), the alleged misrepresentation was also more than copying and
11 distributing copyrighted work and passing it off as one's own.
12 There, the plaintiff alleged that the defendants fraudulently
13 promised that they would honor his copyrighted work and compensate
14 him for it, while concealing from him that they were developing a
15 television show based on his work. Id. at 991. The court stated
16 that it was "a close case, because Plaintiff's misrepresentation
17 causes of action stray dangerously close to restating copyright
18 claims." Id. But, the court concluded that, under Valente-Kritzer
19 Video, the plaintiff added an additional element, i.e., that the
20 defendants fraudulently promised not to violate his authorship
21 rights.

22 Here, the Fovia parties do not allege that the TeraRecon
23 parties fraudulently promised to honor Buyanovsky's right to his
24 engine. They state in their opposition that TeraRecon obtained the
25 engine by Saito's misrepresentations to Buyanovsky regarding the
26 limited uses to which the engine would be put to use. As the
27 TeraRecon parties point out, however, the paragraphs in the amended
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1 counterclaims on which the Fovia parties rely do not allege facts
2 to support a claim of false promise.

3 The Fovia parties' unfair competition claim, founded on
4 allegations that the TeraRecon parties misrepresented that
5 TeraRecon's 3-D volume rendering software is exclusively its own
6 product and that images in TeraRecon's marketing materials were
7 created by its own product, does not address rights which are
8 qualitatively different from copyright rights. Still at issue is
9 the copyright owner's exclusive rights of reproduction, production
10 of derivative works, distribution, and display. See 17 U.S.C.
11 § 106; Wharton v. Columbia Pictures Industries, Inc., 907 F. Supp.
12 144, 146 (D. Md. 1995) (holding that the plaintiff's
13 misrepresentation claim was "equivalent" to the right to prepare
14 derivative works because it concerned the central allegation that
15 the defendants plagiarized his copyrighted screenplay and thus the
16 claim was preempted); Aaqard v. Palomar Builders, Inc., 344 F.
17 Supp. 2d 1211 (E.D. Cal. 2004) (California unfair competition
18 claims were preempted by federal copyright law to extent they
19 asserted that defendant had reproduced and distributed claimant's
20 architectural plans as her own). The alleged misrepresentation
21 claims do not add an extra element which changes the nature of the
22 action. See Valente-Kritzer Video, 881 F.2d at 776. Therefore,
23 they cannot be the basis for a violation of California Business and
24 Professions Code § 17200, and the claim will be dismissed with
25 leave to amend.

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27 Even if the allegations of misrepresentation as currently
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1 plead were not preempted by federal copyright law, the Fovia
2 parties would be required to amend the allegation regarding
3 TeraRecon's false representations because the allegation fails to
4 satisfy the heightened pleading requirements of Rule 9(b) of the
5 Federal Rules of Civil Procedure. Rule 9(b) requires that in "all
6 averments of fraud or mistake, the circumstances constituting fraud
7 or mistake shall be stated with particularity." Fed. R. Civ. P.
8 9(b); see Vess v. Ciba-Geigy Corp. USA, 317 F.3d 1097, 1103-05 (9th
9 Cir. 2003). In Vess, the plaintiff argued that Rule 9(b) did not
10 apply to the claims he brought under the California Consumer
11 Remedies Act and California's unfair business practice laws because
12 those claims do not require a showing of fraud. The Ninth Circuit
13 found that he was correct that fraud is not an essential element of
14 his State law claims, but he was "not correct in concluding that
15 his averments of fraud therefore escape the requirements of the
16 rule." 317 F.3d at 1103. The court stated,

17 This circuit has not analyzed the application of Rule 9(b)
18 in a case where fraud is not an essential element of the
19 claim, and where allegations of both fraudulent and
20 non-fraudulent conduct are made in the complaint. Two of
21 our sister circuits have provided such an analysis,
22 however, and we now join them in holding that in a case
23 where fraud is not an essential element of a claim, only
24 allegations ("averments") of fraudulent conduct must
25 satisfy the heightened pleading requirements of Rule 9(b).
26 Allegations of non-fraudulent conduct need satisfy only
the ordinary notice pleading standards of Rule 8(a). As
the Fifth Circuit wrote:

Where averments of fraud are made in a claim in which
fraud is not an element, an inadequate averment of fraud
does not mean that no claim has been stated. The proper
route is to disregard averments of fraud not meeting Rule
9(b)'s standard and then ask whether a claim has been
stated.

27 Id. at 1104-05 (quoting Lone Star Ladies Inv. Club v. Schlotzsky's

1 Inc., 238 F.3d 363, 368 (5th Cir. 2001)) (emphasis added).

2 Vess is controlling. The misrepresentation allegations must
3 be disregarded because they are not alleged with the required
4 specificity. Without those allegations, a claim for unfair
5 business practices has not been stated, and would be dismissed. If
6 the Fovia parties want their misrepresentation and false promise
7 allegations to be considered, they must be replead to give the
8 TeraRecon parties notice of the particular misconduct alleged so
9 that they can defend against the charge and not just deny that they
10 have done anything wrong. Id. at 1106. As the Ninth Circuit
11 instructs, "Averments of fraud must be accompanied by 'the who,
12 what, when, where, and how' of the misconduct charged." Id.
13 (quoting Cooper v. Pickett, 137 F.3d 616, 627 (9th Cir. 1997)).

14 2. Reverse Passing Off

15 The TeraRecon parties contend that the Fovia parties' "reverse
16 passing off" allegations do not support a claim under § 17200. The
17 Ninth Circuit explains that reverse passing off, or reverse palming
18 off, occurs with the direct misappropriation of the services or
19 goods of another. Summit Mach., 7 F.3d at 1437. The Fovia parties
20 state that they have not asserted a Lanham Act claim for reverse
21 passing off. Regardless, to the extent that they allege reverse
22 passing off, their unfair competition counterclaims are preempted.
23 See Aagard, 344 F. Supp. 2d at 1217 ("Reverse palming off claims
24 are preempted unless they allege bodily appropriation and the
25 claimant seeks more than mere monetary damages.").

1 3. Misappropriation

2 The TeraRecon parties also contend that the Fovia parties'
3 misappropriation allegations do not support a claim for unfair
4 competition under § 17200. According to the amended counterclaim,
5 the TeraRecon parties have a regular practice of depriving Fovia
6 and Fovia Medical of the value of their products and services by
7 misappropriating the engine created by Buyanovsky and incorporating
8 it into TeraRecon's commercially distributed products. ACC ¶ 161.
9 The Fovia parties do not address whether their misappropriation
10 allegations are preempted or whether the allegations support a
11 claim for unfair competition. They point to these allegations only
12 to show wrongful conduct by Saito and Taylor. It appears that this
13 allegation would also be preempted and thus could not support an
14 unfair competition claim. See Summit Mach., 7 F.3d at 1441 (noting
15 that, in the cases finding that a claim for misappropriation is not
16 preempted, "the extra element tends to be apparent").

17 4. Saito and Taylor

18 The TeraRecon parties contend that the amended counterclaim
19 fails to state a claim under § 17200 against Saito and Taylor
20 because it describes no conduct by either Saito or Taylor and
21 because the claim is time-barred.

22 The Fovia parties point to allegations in the complaint of
23 wrongful conduct by Saito and Taylor. As noted above, the Fovia
24 parties allege that Saito and Taylor misappropriated the engine.
25 It is also alleged that Saito and Taylor "misrepresented
26 TeraRecon's rights relating to the Buyanovsky Engine to the medical
27 imaging community and to Fovia and Fovia Medical's prospective
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1 customers." ACC ¶ 171. These allegations, however, fail for the
2 reasons stated above: a claim based on misappropriation of the
3 engine appears to be preempted and the alleged misrepresentations
4 must be disregarded, pursuant to Vess, because they are not alleged
5 with the required specificity.

6 This unfair competition claim against Saito and Taylor,
7 however, is not time-barred. A claim can be dismissed as time-
8 barred only where it is evident on the face of the complaint that
9 the claim is necessarily barred. See, e.g., Mertens v. Hewitt
10 Associates, 948 F.2d 607, 613 (9th Cir. 1991), aff'd, 508 U.S. 248
11 (1993) (dismissing "on statute of limitations grounds is improper
12 where the complaint merely shows that the action may have been
13 barred") (inner quotation omitted). The statute of limitations on
14 a claim under § 17200 is four years, and it begins "to run on the
15 date the cause of action accrued, not on the date of discovery."
16 Karl Storz Endoscopy Am., Inc. v. Surgical Techs., Inc., 285 F.3d
17 848, 857 (9th Cir. 2002); Cal. Bus. & Prof. Code § 17208. Thus, a
18 delay in discovering that TeraRecon was allegedly using the engine
19 without permission does not save the claim from the time bar. It
20 is not clear from the complaint exactly when TeraRecon incorporated
21 and used the engine in its products. It is only alleged that
22 TeraRecon did so after the Radiological Society meeting, because
23 Buyanovsky allegedly did not grant TeraRecon rights to use the
24 engine in its products after the conference. Because it is not
25 clear on the face of the complaint that this counterclaim is time-
26 barred, the Court need not address whether the statute of
27 limitations is tolled as to claims asserted against officers and
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1 directors of a corporation when the corporation commences
2 litigation.

3 B. Intentional Interference with Prospective Economic
4 Advantage

5 The Fovia parties state that they have revised their third
6 counterclaim for intentional interference with prospective economic
7 advantage to cure all the alleged pleading defects the TeraRecon
8 parties raised in their motion to dismiss. The amended
9 counterclaim now alleges that TeraRecon, Saito and Taylor have
10 intentionally interfered with the Fovia parties' business
11 relationships "through improper means, including by making false
12 and misleading statements to Fovia and Fovia Medical's prospective
13 customers that Fovia and Fovia Medical have copied TeraRecon's
14 software, have misused TeraRecon's trade secrets, and no longer
15 have the right, authority and license to use, produce and
16 distribute their medical imaging products. TeraRecon, Saito and
17 Taylor have also misrepresented TeraRecon's rights relating to the
18 Buyanovsky Engine to the medical imaging community and to Fovia and
19 Fovia Medical's prospective customers." ACC ¶ 170.

20 As the TeraRecon parties note, this allegation does not
21 satisfy the requirements of Rule 9(b). Rule 9(b) "requires that a
22 plaintiff plead with sufficient particularity attribution of the
23 alleged misrepresentations or omissions to each defendant." In re
24 Silicon Graphics, Inc. Sec. Litig., 970 F. Supp. 746, 752 (N.D.
25 Cal. 1997). The Fovia parties contend that Rule 8(a), not Rule
26 9(b), applies to intentional interference claims and, thus, they
27 have meet their pleading requirements. Citing a case from a
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1 Florida District Court, the Fovia parties state that Rule 9(b)'s
2 heightened pleading requirement is limited to claims of common law
3 and statutory fraud. See Lockheed Martin Corp. v. Boeing Co., 2005
4 WL 729685, *2 (M.D. Fla. Mar. 21, 2005). That is incorrect. As
5 discussed above, even where fraud is not a necessary element of a
6 claim, where a party alleges that the other party engaged in some
7 fraudulent and some non-fraudulent conduct, the allegations of
8 fraud must be plead with particularity or be disregarded. Vess,
9 317 F.3d at 1103-04.

10 In Meridian Project Systems, Inc. v. Hardin Construction Co.,
11 404 F. Supp. 2d 1214, 1220 (E.D. Cal. 2005), the defendant brought
12 a counterclaim for intentional interference with prospective
13 economic advantage based on the plaintiff's alleged
14 misrepresentations to prospective customers that it had infringed
15 the plaintiff's copyright. The court found that, while fraud was
16 not an element of an intentional interference with prospective
17 economic advantage claim, the counterclaim had alleged that the
18 counterdefendant engaged in fraudulent conduct, i.e., the allegedly
19 false statement that the counterclaimant violated the
20 counterdefendant's copyright. Thus, the court applied Rule 9(b) to
21 the allegations that the counterdefendant made intentional
22 misrepresentations. Some of the allegations passed muster under
23 Rule 9(b) "because they described the who, what, where, when and
24 how of the alleged misrepresentations." Id. at 1220. The
25 allegations that did not satisfy the requirements of Rule 9(b) were
26 disregarded in determining whether a claim was stated.

1 Without the intentional misrepresentation allegations that do
2 not meet the specificity requirements of Rule 9(b), the Fovia
3 parties allege that the TeraRecon parties interfered with their
4 business relationships through "improper means." Although the
5 Rules do not require the Fovia parties to describe in detail these
6 "improper means," they must provide the TeraRecon parties fair
7 notice of what their claim is and the grounds on which it rests.
8 They do not. Therefore, the third counterclaim is also dismissed
9 with leave to amend.

10 C. Negligent Interference with Prospective Economic Advantage

11 The Fovia parties amended their fourth claim to delete Saito
12 and Taylor and to add specific allegations of negligence. As they
13 note, however, this claim also alleges that TeraRecon made
14 misleading statements to prospective customers, in addition to
15 misrepresenting its rights relating to the engine. Those
16 allegations, like the similar allegations discussed above, are not
17 plead with the specificity required by Rule 9(b) and thus must be
18 disregarded. See Vess, 317 F.3d at 1105. Without those
19 allegations, the counterclaim only states that TeraRecon has
20 negligently interfered with Fovia and Fovia Medical's prospective
21 business relationships. Conclusory allegations are insufficient to
22 defeat a motion to dismiss for failure to state a claim. Epstein
23 v. Wash. Energy Co., 83 F.3d 1136, 1140 (9th Cir. 1996). Thus, the
24 fourth counterclaim is also dismissed with leave to amend.

25 II. Motion for leave to amend complaint

26 Plaintiff TeraRecon seeks leave to file its proposed second
27 amended complaint. The proposed second amended complaint would add
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1 new claims for relief, amend claims for relief already plead and
2 omit some claims against one of the defendants. According to
3 Plaintiff TeraRecon, the proposed second amended complaint also
4 corrects certain errors and clarifies ambiguous language.

5 Recognizing the liberal policy favoring amendment under Rule
6 15, Defendants state that they do not object to Plaintiff
7 TeraRecon's amended factual allegations. Nor do Defendants object
8 to Plaintiff TeraRecon's proposed amended claims for declaratory
9 relief and interference with prospective economic advantage. But
10 Defendants contend that the conversion claim is futile and that the
11 trade secrets misappropriation, section 17200 and contract claims
12 are futile in part; thus, Defendants argue that Plaintiff
13 TeraRecon's motion for leave to amend should be denied in part.

14 The Supreme Court has identified four factors relevant to
15 whether a motion for leave to amend should be denied: undue delay,
16 bad faith or dilatory motive, futility of amendment and prejudice
17 to the opposing party. Foman v. Davis, 371 U.S. 178, 182 (1962).
18 Here, only futility is at issue. As Defendants note, "Futility of
19 amendment can, by itself, justify the denial of a motion for leave
20 to amend." Bonin v. Calderon, 59 F.3d 815, 845 (9th Cir. 1995).
21 The Ninth Circuit instructs that "a proposed amendment is futile
22 only if no set of facts can be proved under the amendment to the
23 pleadings that would constitute a valid and sufficient claim or
24 defense." Miller v. Rykoff-Sexton, Inc., 845 F.2d 209, 214 (9th
25 Cir. 1988); see also SAES Getters S.p.A. v. Aeronex, Inc., 219 F.
26 Supp. 2d 1081, 1086 (S.D. Cal. 2002) ("an amendment is 'futile'
27 only if it would clearly be subject to dismissal").

1 A. Conversion

2 Plaintiff TeraRecon seeks to allege that Defendants unlawfully
3 converted its property rights in its trade secrets. It defines its
4 trade secrets as including the computer code, confidential
5 information concerning its customers and potential customers,
6 business plans and other corporate planning documents, and products
7 plans. Defendants argue that Plaintiff TeraRecon's proposed
8 conversion claim is futile for three reasons: (1) conversion does
9 not apply to intellectual or intangible property; (2) the claim is
10 preempted by the Copyright Act; and (3) the claim is preempted by
11 California's Trade Secret Act.

12 1. Intangible property

13 Citing Olschewski v. Hudson, 87 Cal. App. 282, 286 (1927),
14 Defendants contend that the tort of conversion applies only to
15 tangible, certain and definite property. The Ninth Circuit,
16 however, has found otherwise. Kremen v. Cohen, 337 F.3d 1024 (9th
17 Cir. 2003). As Defendants acknowledge, the court in Kremen found
18 that a claim for conversion of an internet domain name can be
19 brought under California law. Defendants assert that the court's
20 holding was limited to its finding that a domain name could be
21 unlawfully converted because it was a well-defined interest and
22 because the connection between the domain names and an electronic
23 domain name server database was sufficient to satisfy any merger
24 requirement under California law. The court's holding in Kremen,
25 however, was not so limited. After a detailed analysis of
26 conversion of intangibles, the court concluded:

1 In short, California does not follow the Restatement's
2 strict requirement that some document must actually
3 represent the owner's intangible property right. On the
4 contrary, courts routinely apply the tort to intangibles
5 without inquiring whether they are merged in a document
6 and, while it's often possible to dream up some document
7 the intangible is connected to in some fashion, it's
8 seldom one that represents the owner's property interest.
9 To the extent Olschewski endorses the strict merger rule,
it is against the weight of authority. That rule cannot
be squared with a jurisprudence that recognizes conversion
of music recordings, radio shows, customer lists,
regulatory filings, confidential information and even
domain names. . . . Assuming arguendo that California
retains some vestigial merger requirement, it is clearly
minimal, and at most requires only some connection to a
document or tangible object.

10 Id. at 1033. Here, Plaintiff TeraRecon meets that minimal
11 requirement; Plaintiff TeraRecon's computer code, confidential
12 information concerning its contracts with customers, business plans
13 and product plan are reflected in or have the necessary connection
14 to paper and electronic documents.

15 Furthermore, as Plaintiff TeraRecon notes, Kremen is not the
16 only case to distinguish Olschewski, the main case Defendants rely
17 upon. In Palm Springs-La Quinta Development Co. v. Kieberk Corp.,
18 46 Cal. App. 2d 234 (1941), the court upheld a conversation claim
19 for intangible information in a customer list when some of the
20 index cards on which the information was recorded were destroyed,
21 allowing damages for both the value of the cards and the value of
22 the intangible information lost. The court explained that the
23 defendant in Olschewski "was charged with selling the good-will of
24 a business in a specified district" and that the court "merely held
25 that was an intangible property right which is not susceptible of
26 conversion." 46 Cal. App. 2d at 240.

1 Defendants' argument that Plaintiff TeraRecon's conversion
2 claim is futile because conversion does not apply to intellectual
3 or intangible property fails.

4 2. Preemption by copyright law

5 As discussed above, a State law claim is preempted by federal
6 copyright law unless it contains an additional element that changes
7 the nature of the action so that it is qualitatively different from
8 a copyright infringement claim. Defendants contend that Plaintiff
9 TeraRecon's conversion claim is directed to the copying or use of
10 the computer code, which is protected by the Copyright Act, and
11 thus it is preempted. Plaintiff TeraRecon's conversion claim,
12 however, encompasses more than just its computer code. As
13 mentioned above, Plaintiff TeraRecon alleges that Defendants have
14 also converted its business plans and customer information,
15 materials that are outside the scope of the Copyright Act. The
16 Court finds that Plaintiff TeraRecon has sufficiently alleged the
17 additional elements of its conversion claim to defeat Defendants'
18 preemption argument.

19 Defendants' argument that Plaintiff TeraRecon's conversion
20 claim is futile because it is preempted by copyright law also
21 fails.

22 3. Preemption by California's Trade Secret Statute

23 Defendants argue that to the extent it is premised on the use
24 of any trade secret information, Plaintiff TeraRecon's proposed
25 conversion claim is precluded by California's trade secret statute,
26 which preempts all common law claims that are based on
27 misappropriation of a trade secret. See Digital Envoy, Inc. v.

1 Google, Inc., 370 F. Supp. 2d 1025, 1035 (N.D. Cal. 2005).

2 Plaintiff TeraRecon notes that it did not incorporate by reference
3 its allegation that its proprietary materials are trade secrets in
4 its proposed claim for conversion and that, for this claim, it does
5 not allege such. Plaintiff TeraRecon states that this is an
6 alternative theory, which it is allowed to plead.

7 Defendants' argument that Plaintiff TeraRecon's conversion
8 claim is futile because it is preempted by California's Trade
9 Secret Act also fails. The Court concludes that Plaintiff
10 TeraRecon's claim for conversion is not futile.

11 B. Breach of Contract Claim

12 Plaintiff TeraRecon states that its proposed amendments to its
13 breach of contract claims clarify those claims by asserting
14 separate claims against separate Defendants. Defendants respond
15 that they do not seek to prevent amendment of Plaintiff TeraRecon's
16 proposed breach of contract claims insofar as they allege that
17 Buyanovsky, Fineman, Katen and Okulist were prohibited from using
18 or disclosing Plaintiff TeraRecon's trade secrets after termination
19 of their employment. Nor do Defendants object to the amendments to
20 the extent that they focus solely on the use of trade secrets to
21 solicit Plaintiff TeraRecon's customers. But, to the extent
22 Plaintiff TeraRecon alleges that the individual Defendants breached
23 their agreements with Plaintiff TeraRecon by competing against
24 Plaintiff TeraRecon, Defendants contend that those claims are
25 barred by California Business and Professions Code § 16600, which
26 provides that a contract "by which anyone is restrained from
27 engaging in a lawful profession, trade, or business of any kind is
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1 to that extent void." Defendants argue that Plaintiff TeraRecon
2 fails to restrict its claims exclusively to those based on the use
3 of trade secrets, and, because those restrictions are not
4 explicitly incorporated into the amendments, the amendments are
5 futile.

6 As Plaintiff TeraRecon notes, however, its proposed amended
7 pleading clarifies that it is not alleging breach based solely on
8 Defendants' competition with Plaintiff TeraRecon. Nowhere in the
9 amended claims does Plaintiff TeraRecon allege that Defendants
10 breached their employment contracts by competing with Plaintiff
11 TeraRecon after leaving Plaintiff TeraRecon's employ. Furthermore,
12 Defendants provide no authority to support their argument that
13 "legal restrictions must be explicitly incorporated into the
14 amendments or the amendments are futile." The Court finds that
15 Plaintiff TeraRecon's amended breach of contract claims are not
16 futile.

17 C. Trade Secrets Misappropriation Claim

18 Plaintiff TeraRecon's first amended complaint alleged trade
19 secrets, "including but not limited to, the Computer Code."
20 Plaintiff TeraRecon now seeks to amend its complaint to allege that
21 its trade secrets include "Computer Code; confidential information
22 concerning TeraRecon's customers and potential customers, including
23 TeraRecon's contractual relations with GEMS IT, Siemens, and
24 others; business plans and other corporate planning documents; and
25 product plans."

26 Defendants contend that Plaintiff TeraRecon's amendment would
27 be futile because it adds new trade secrets claims that are time-

1 barred. As discussed above, a claim is barred by the statute of
2 limitations as a matter of law if it is untimely on the face of the
3 pleadings. The statute of limitations for a claim under
4 California's Trade Secret Act is three years. Cal. Civ. Code
5 § 3426.6. According to Defendants, the complaint alleges that the
6 statute of limitations began to run in January, 2003, when Fineman
7 resigned, allegedly taking Plaintiff TeraRecon's laptop, containing
8 its trade secrets, with him. Plaintiff TeraRecon's original
9 complaint, filed in 2005 before the statute of limitations expired,
10 mentioned only the computer code and not any other trade secrets.
11 Now, after three years have passed, Plaintiff TeraRecon attempts to
12 add other trade secrets.

13 As Plaintiff TeraRecon notes, however, Defendants' argument
14 fails to address the relation back doctrine addressed in Plaintiff
15 TeraRecon's motion for leave to amend. There is no dispute that
16 these amended claims arise "out of the conduct, transaction, or
17 occurrence set forth or attempted to be set forth in the original
18 pleading." Fed. R. Civ. P. 15(c). Therefore, the amendments
19 relate back to the date of the original complaint. See, e.g., Kern
20 Oil & Refining Co. v. Tenneco Oil Co., 840 F.2d 730 (9th Cir.
21 1988). Even if these are new trade secrets, as Defendants contend,
22 these added claims would not be time-barred.

23 The Court finds that Plaintiff TeraRecon's amended trade
24 secrets misappropriation claim would not be futile.

25 D. § 17200 Claim

26 Plaintiff TeraRecon seeks to eliminate the "pattern" language,
27 which is not required by § 17200, and to incorporate by reference
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1 the general allegations of trade secret misappropriation.
2 Defendants state that they do not object to the proposed amended
3 claim to the extent that it is based solely on an alleged breach of
4 fiduciary duty. But, to the extent that Plaintiff TeraRecon's
5 proposed amendment to its § 17200 claim relies on factual
6 allegations of copyright infringement or trade secret
7 misappropriation, Defendants contend that the claim is preempted by
8 both federal copyright law and California's trade secret law. That
9 may be; however, that does not make Plaintiff TeraRecon's amendment
10 futile. As stated above, denial of an amendment as futile is
11 appropriate only if no set of facts can be proved under the
12 amendment which would constitute a valid claim. Miller, 845 F.2d
13 at 214. Plaintiff TeraRecon states that Defendants have committed
14 acts, alleged in the complaint, that violate California's Unfair
15 Competition Law. As long as one of those alleged acts is not
16 preempted, then Plaintiff TeraRecon's amendment to this claim is
17 not futile. Because not all of the alleged acts are preempted, the
18 Court finds that Plaintiff TeraRecon's amended § 17200 claim is not
19 futile.

20 CONCLUSION

21 For the foregoing reasons, the Court GRANTS the TeraRecon
22 parties' motion to dismiss counterclaims (Docket No. 23). The
23 Fovia parties' second, third and fourth claims for relief are
24 dismissed with leave to amend. They must file their second amended
25 counterclaims within fourteen days from the date of this order.
26 Plaintiff TeraRecon's motion for leave to amend its complaint
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1 (Docket No. 27) is also GRANTED.

2 IT IS SO ORDERED.

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4 Dated: 7/6/06



CLAUDIA WILKEN
United States District Judge

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